No. 83-832

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1983

Harold T. and Marie B. Paulsen,

Petitioners,

vs.

Commissioner of Internal Revenue,

Respondent.

AMICUS CURIAE BRIEF OF CALIFORNIA LEAGUE OF SAVINGS INSTITUTIONS IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE U.S. COURT OF APPEALS FOR THE NINTH CIRCUIT.

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I

QUESTION PRESENTED

Does the sole form of direct equity ownership that a Federally chartered mutual savings and loan association can furnish to the stockholders of a stock savings and loan pursuant to a plan of reorganization within the meaning of Section 368(a)(1)(A) of the Internal Revenue Code, namely ownership of savings accounts in the Federal mutual savings and loan association, qualify for the tax-free exchange provisions of Section 354(a)(1) of the Internal Revenue Code?

II

INTEREST OF AMICUS CURIAE

The California Savings and Loan League ("California League") is a trade Association organized as a tax

exempt organization pursuant to Section 501(c)(6) of the Internal Revenue Code. Its membership consists of substantially all of the savings and loan associations, both stock and mutual, authorized to conduct business within the State of California. As of the final quarter of calendar 1983, there were approximately 250 such associations, of which about 150, with a total of approximately $165 billion in assets, were stock companies; and the remainder, with a total of approximately $25 billion in assets, were mutuals.

As explained in §III, infra, the opportunity for savings and loan associations to acquire other savings and loan associations through voluntary merger is essential to enable the savings and loan industry to accommodate

to changing circumstances and thus maintain economic viability. Yet unless the question presented is resolved in the affirmative, that opportunity will be needlessly curtailed.

III

ARGUMENT

A. The Question Presented Is Of Substantial Importance.

The savings and loan industry in the United States, composed of approximately 3,800 separate institutions with total assets of more than $700 billion, is a primary source of financial services for the American public. (U.S. League of Savings Institutions, Source book, (1983), pp. 36-37). Savings and loan associations

(most of the deposits of which are insured by an agency of the United States, the Federal Savings and Loan Insurance Corporation), in addition to the myriad of other services that they perform, are both depositories for the savings of millions of Americans and the largest source of residential real estate financing in the Nation. (U.S. League of Savings Institutions, Source book, (1983), p. 8. The operation of the savings and loan industry has significant ramifications for the real estate construction industry, the real estate sales industry, and the economy of the Nation as a whole. (U.S. League of Savings Institutions, Source book, (1983), p. 5).

One of the principal mechanisms employed by business entities

to adjust to changing circumstances is merger with other entities; and that mechanism has, historically, been of particular importance to the savings and loan industry.

The economic and technological environment in which savings and loan associations function has changed dramatically in recent years. Legally imposed ceilings on the interest rates that banks and savings and loan associations may pay depositors are in the process of being (and, indeed, largely have already been) phased out (see Depository Institutions Deregulation Act of 1980, sections 202(b), 204 and 205(a)); the range of services which savings and loan associations may provide has been greatly expanded (see generally 12 C.F.R. §545.1 et seq.);

savings and loan associations, previously confined for the most part to operating within a single state, have, under limited circumstances, been permitted to "go nationwide" by acquiring branches in multiple states (see Home Owners' Loan Act of 1933 as amended, section 5(r); 12 C.F.R. §556.5(a)(3)(ii)); and computerization has affected the way in which savings and loan associations deliver their services, including, for example, enabling them to provide services at locations remote from branches through so-called "remote service units" (see 12 C.F.R. §545.141(a)(3)).

Given such changes, a widespread reconfiguration of the industry through merger is taking place. Since 1980 alone, for example, more than one

thousand savings and loan associations, with assets in excess of one hundred and thirty four billion dollars, have been acquired by other associations (Kaplan Smith Report, September 1983, p. 2; published by Kaplan, Smith & Associates, Inc., 919 Eighteenth Street, N.W. Washington, D.C.) Moreover, it is obvious that the merger process is likely to be of continuing, and perhaps even accelerating, importance to the savings and loan industry in the foreseeable future.

Mergers may be structured as tax-free reorganizations within the meaning of §368(a)(1)(A) of the Internal Revenue Code in which an equity interest in the acquiring association is exchanged for the equity interest of the owners in the acquired association.

Indeed, although the League is not aware of any statistics to which it may cite in this regard, it is not unreasonable to assume that the vast majority of mergers that now take place are, and would not be economically feasible unless they could be, so structured.

While mergers may take place by a mutual association acquiring another mutual association, by a stock association acquiring another stock association, or by a stock association acquiring a mutual association, a fourth possibility is for a mutual association to acquire a stock association; and it is a possibility of obvious pragmatic significance. Of the approximately 3,800 savings and loan associations in the United States today, about 3,000, with assets of $486 billion, are mutual

associations (U.S. League of Savings Institutions, Source book, (1983), pp. 36-38).[1/] Moreover, in any given situation a large mutual association may, in economic terms be the most suitable (and perhaps the only) potential acquirer of a stock association.

The only direct equity interest which exists in a mutual savings and loan association, however, and thus the only equity interest available to the association to exchange for the stock of the acquired institution, is its savings accounts. Hence unless the exchange of savings accounts in a mutual association for stock in a

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1/ Until recently the entire federal savings and system was composed exclusively of mutual institutions. (See footnote 4, infra.)

stock association satisfies the requirements of §368(a)(1)(A), as a practical matter the acquisition by a federal association of a stock association through a direct exchange of equity would not be feasible; and, as a result, the universe of potential acquirers of stock associations through direct exchange of equity interests would be drastically diminished, to the detriment of the savings and loan industry, the

public that it serves, and, ultimately, the federal fisc itself. (See §III.C., infra.)[2/]

2/ While the acquisition of a stock association by a mutual association may theoretically be effected by other than a direct exchange of equity interests, such other transactions are often infeasible, either because of the tax consequences or for other reasons. If the acquisition of a stock association by a mutual association is treated as a taxable purchase of assets at the corporate level, rather than as an exchange of equity interests qualifying as a reorganization within the meaning of §368(a)(1)(A), the carryover provisions of §381 are inapplicable at the corporate level. In that event, severe additional tax liabilities would normally be incurred by both the acquired mutual and the acquiring stock association.

B. The Decision Of The United States Court of Appeals For The Ninth Circuit In Paulsen v. Commissioner, No. 82-7329, Has Engendered A Pernicious Uncertainty With Regard To The Proper Resolution Of The Question Presented.

Prior to the decision of the Ninth Circuit in Paulsen v. Commissioner, No. 82-7329 ("Paulsen"), the law was well established that transactions in which mutual savings and loan associations acquired stock savings

and loan associations through a direct exchange of equity interests were not precluded from constituting plans of reorganization within the meaning of Section 368(a)(1)(A) of the Internal Revenue Code merely because the equity interest given by the mutual association in exchange for the equity interest in the stock association was savings accounts in the acquiring institution. See Capital Savings and Loan Association v. United States, 607 F.2d 970 (Ct. Cl. 1979); West Side Federal Savings and Loan Association v. United States, 494 F.2d 404 (6th Cir. 1974); Everett v. United States, 448 F.2d 357 (10th Cir. 1971).

Paulsen, however, is contrary to the preexisting law and thus engenders doubt as to its continuing

viability, particularly within the jurisdiction of the United States Court of Appeals for the Ninth Circuit and other jurisdictions that have not yet passed on the question presented; and that doubt is, as a practical matter, likely to have the pernicious consequence of deterring future transactions of the type in question.

C. The Resolution Of The Question Presented By The United States Court Of Appeals For The Ninth Circuit In Paulsen Is Inimical To The Public Welfare And Therefore Contrary To Sound Public Policy.

The effect of the Paulsen decision is to preclude mutual savings and loan associations, both federally chartered and state chartered, from utilizing the tax deferral allowances of Internal Revenue Code §§ 368(1)(A) and 354(a)(1) in the acquisition of stock associations through the direct exchange

of equity interests and thus relegate such mutual associations to a disfavored tax status not shared either by stock savings and loan associations or corporations generally. That effect is inimical to the public welfare and, therefore, inconsistent with sound public policy. In particular:

1. As indicated in §III.A., supra, mergers are one of the principal mechanisms employed by the savings and loan industry to adjust to changing circumstances. Excluding mutual savings and loan from the opportunity to acquire stock associations through the direct exchange of equity interests drastically curtails merger opportunities for the savings and loan industry and, by so reducing the universe of potential acquirers, artifically distorts the

merger market. As a consequence, the value of the equity ownership of stock in associations is depressed to a level lower than that which would otherwise prevail; and, perhaps even more important, the incentive of stock associations to merge is reduced -- this even though merger may in a given situation, be the course best calculated to serve the public interest.

2. Mutual and stock savings and loan associations engage in the same activities and compete with each for the same business; and thus, in terms of their operations and in most basic respects, they are functional equiva-

lents.[3/] Yet since mutuals are unable to offer the owners of a stock association tax-free consideration for their equity interest, they are placed at a significant and functionally unwarranted

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3/ While there are differences between the operational powers of federal associations and the operational powers of state chartered associations of some states, the operational powers of a federal association are the same whether it is mutual or stock. (See Home Owners' Loan Act of 1933 As Amended, Section 2(d) and 12 C.F.R. §541.8 (defining a federal association), and Home Owners' Loan Act of 1933 As Amended, Section 5 and 12 C.F.R. §541 et seq. (specifying the powers of such an association).) Moreover, and although it lacks specific information in this regard, the League assumes that under most state laws the operational powers of stock and mutual associations are substantially the same.

disadvantage via-a-vis their stock competitors.[4/]

3. All federally chartered savings and loan associations, both stock and mutual, and the vast majority of state chartered savings and loan

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4/ Such a competitive disadvantage is particularly ironic in light of the fact that in 1954 when the pertinent Internal Revenue Code sections were enacted, all federally chartered savings and loan associations were mutual (see Depository Institutions Deregulation Act of 1980, section 404, allowing federally chartered stock associations for the first time); and federally chartered savings and loan associations are agencies and instrumentalities of the United States. (See, e.g., Federal Land Bank v. Bismarck Lumber Co., 314 U.S. 95, 102 (1941); United States v. State Tax Commission, 481 F.Supp 963, 969 (1st Cir. 1973); see also 12 C.F.R. §545.17). Indeed, Thus the Paulsen decision necessarily assumes that in enacting the pertinent Internal Revenue Code sections, Congress intended to place federal agencies and instrumentalities at a significant competitive disadvantage, vis-a-vis their nonfederal competitors -- a highly dubious assumption, to say the least.

associations, both stock and mutual, are insured by an agency of the United States, the Federal Savings and Loan Insurance Corporation; and there is a resolution of Congress to the effect that the federal treasury itself will "stand behind" the insurance obligations of that agency. (H. Con.Res. 290 (March 18, 1982); accord: S. Com. Res. 72 (March 24, 1982)). Hence, to the extent that troubled or potentially troubled stock institutions are deprived of merger opportunities, and these institutions subsequently fail or are merged only with the assistance of the Federal Savings and Loan Insurance Corporation, the risk to the Federal Savings and Loan Insurance Corporation,

and even the federal fisc itself, is gratuitously exacerbated.[5/]

IV

CONCLUSION

The question presented is important; the Paulsen decision has generated a pernicious uncertainty with regard to the resolution of that question which did not previously exist; and the resolution of the question presented in Paulsen is inimical to the

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5/ Indeed, since there are limits on the amount of insurance coverage provided by the Federal Savings and Loan Insurance Corporation for each account, &100,000 at present, the direct risk to memebers of the general public itself, in their capacity of depositors holding accounts in excess of $100,000, is also gratuitously exacerbated.

public welfare and therefore contrary to sound public policy.

The petition for writ of certiorari should be granted.

Respectfully submitted,

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